DOW THEORY LETTERS INC.

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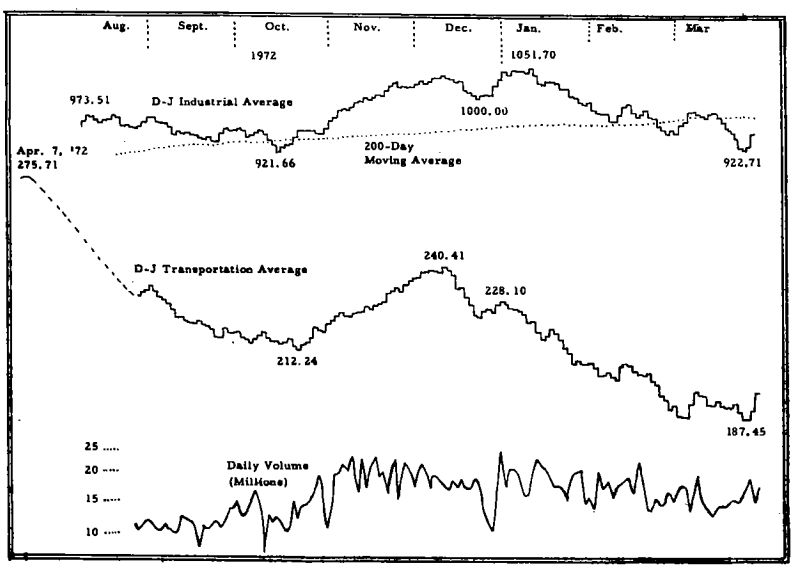
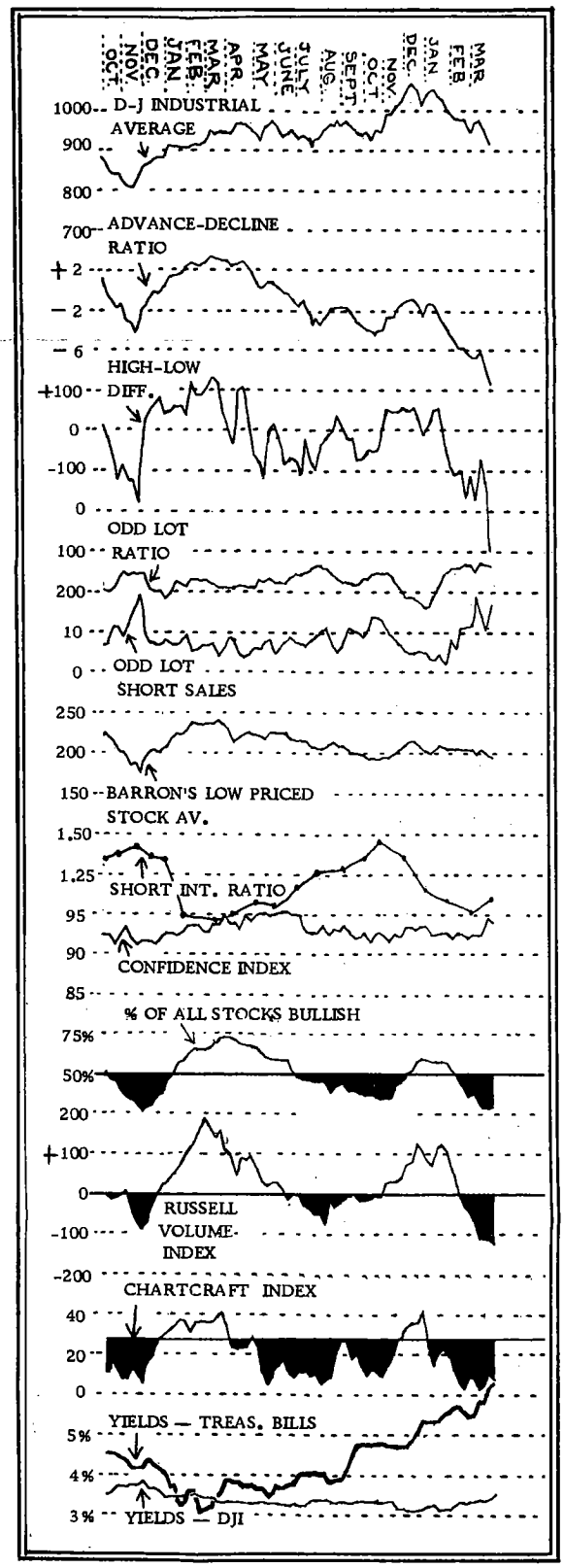
PRIMARY TREND: A subscriber recently asked me, "What is the hardest thing for the non-professional like me to understand about the stock market?" Without a moment's hesitation I answered, "The fundamental concept of the primary trend. But let me add, the professional generally has as much trouble as the newcomer in understanding the primary trend principle."

The primary trend can be defined as the great, tidal force of the market, the force which underlies the long-term direction. This force can perhaps be best likened to the life of a man. A man goes from infancy to youth to middle age. No one has ever been able to reverse that process, although many men seem temporarily to "beat" nature by looking thirty when they are really forty-five. Ultimately, however, old age and death take over. The growth from infancy to peak performance may be considered man's bull market. The bear market period is from peak performance to death. Man fears and hates death, yet no one denies the inevitability of the grim reaper.

Although not an exact comparison, I would consider a man's child to be the new bull market. And so the cycle continues. The length of the bull markets and bear markets may vary, but the actual cycles of rise and fall remain the same. And so it is with primary bull and bear markets on Wall Street. Strangely, there are few who envision the process in this way.

The difficulty in understanding the Wall Street picture is that man likes to believe that everything is in his control. How can there be cycles and forces which he cannot harness or handle? Here man's monumental ego is involved. So the problem in comprehending the primary trend is that (1) men tend to believe what they want to believe, and (2) Government (particularly in recent years) manipulates the market so that the market





 (temporarily) tends to reflect what the Government's propaganda machine wants it to reflect. The power of mass wishing ("We're bullish on America") plus the power of Government to reinforce those wishes is a power to reckon with, no question about it. But wishes and manipulations are not enough. For despite all the power of the Administration, the Federal Reserve Board, the Treasury and Congress, a primary bull market or bear market, once in force, will continue to completion.

Perhaps it is this "inevitable" characteristic of the primary trend which is so difficult for the average man to accept. How many times have I heard someone say, "Russell, what would you have to see before you turned bullish on the market?" My answer (guaranteed to frustrate) is, "I would have to see this primary bear market run to conclusion; I would have to see a major decline which would take stock prices to great values, stock yields back to the 6% or better area again, acute pessimism on Wall Street, low volume on the NYSE (and I mean low), in other words, most of the classical signs of a major bear market bottom."

In my opinion, the Government, via massive manipulation, has held back the primary bear market, the bear market which I believe started in February, 1966. Had the Government not injected the economy with massive and continued doses of inflation, I believe the 1966 bear market would now be over and that a new primary bull market would be in progress. Instead, rampant inflation, a fiat currency, "sandwiched" metal coins and a cut-rate bond market have been the price paid for an economy and stock market which have been literally "floated up" by inflation.

I have explained in many reports (the latest being Letter 557) exactly why I think that the great bull market which began in June, 1949, topped out in February of 1966. Since the 1966 top, the market has been subject to a series of puzzling, divergent and disparate movements in which some of the major stock averages have pushed to new highs while other (usually non-weighted) averages acted as if they were made of lead. At the same time the NYSE advance-decline ratio (as late as last week) broke to a fresh low for the entire bear market, actually sinking to its lowest level since the mid-1940's.

The fact is that this market has been eroding (as far as the advance-declines are concerned) ever since the April, 1971, high. A rally took place during November, 1971 to March, 1972. The sinking process then began anew. A three-month rally occurred starting in October, 1972, and by January, 1973 it was all over. Since the first of this year the primary bear market has taken hold with a vengeance. This time, everything has gone down, including the Dow Industrial Average itself.

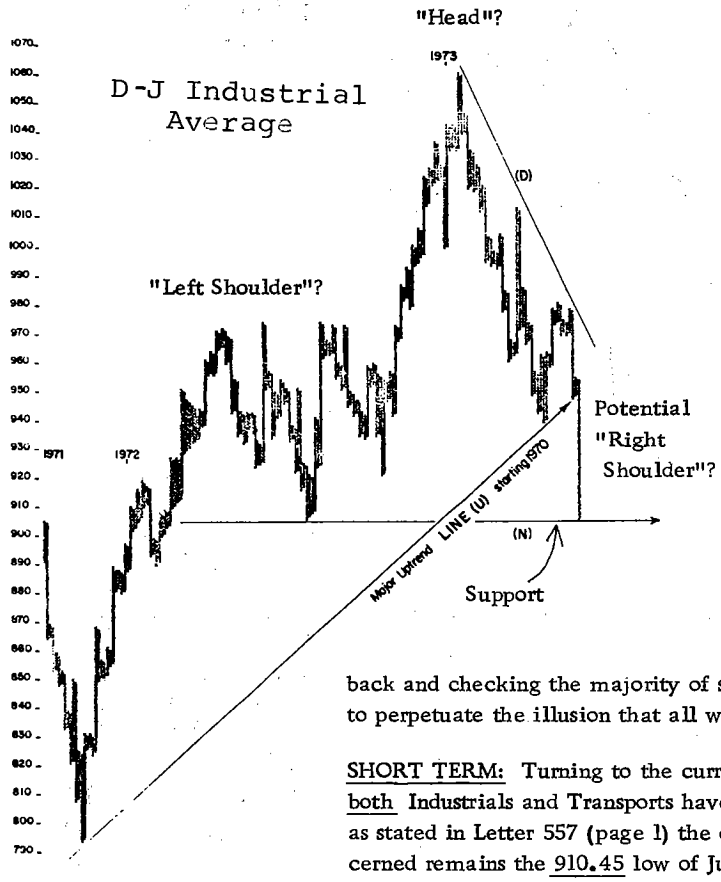
From the long-term standpoint, this "upward correction" or counter-trend rise in the Dow since 1970 has now consumed 30 months. This is an unbelievably long time for the Dow to "fight" the primary trend. As a rule, the longer and more stubborn the move against the prevailing primary direction, the more drastic, violent and persistent the ultimate resumption of the primary movement. That, I feel, is what we are seeing now!

There is an added ingredient which I have been calling attention to for many months. It is the dangerously extended margin situation. In early 1966, just before the first bear market slide, NYSE margin debt was around $5.5 billion. In early 1969, prior to the second smashing decline, Big Board margin debt was above $6 billion. The market entered 1973 with margin debt at a whopping $7.9 billion. My belief is that this huge, bloated margin debt is now in the process of being squeezed out, and the latest figure in Barron's shows NYSE margin debt down to $7.5 billion. This is still an enormous amount of money on margin, and it would not surprise me to see this figure shrink to $1-2 billion before the primary bear market breathes its last!

The advisory services are aghast at the extent and persistence of the current selling. Many have been shouting "oversold" and "rally just around the corner" for weeks and even months. But the market is a law unto itself, and as I have said before, a market can be oversold (as this one is) and stay oversold for a long time (this is, of course, particularly true during a primary bear market).

The power of the current decline is something far out of the ordinary. It's a situation wherein (despite good corporate news, bullish earnings, encouraging words from political leaders) the market is writing its own script. I have included a chart (page 3) from the Dines Letter (18. E. 41st St., NYC), and it portrays rather dramatically the great 1973 downward "thrust" of the Dow. If we get a rally from the 900-920 area we could build a "right shoulder" for a potential "head-and-shoulders" top. But why try to outguess the bear? I continue to advise holding gold shares and cash (cash in the form of Treasury bills or certificates of deposit in good, conservative banks).

A number of subscribers have written to ask about phases in this primary bear market. I am of the opinion that we are still in the second psychological phase of the bear market. This is traditionally the longest and most deceptive phase, and it is living up to its advance billing. In the second phase stocks ultimately go down in response to deteriorating economic, social or political reasons, and in the current instance it would appear that all three will combine to drive the Averages down to and below their 1970 lows.



The third or final phase of a bear market is the "distress phase," the one in which stocks are sold for no other reason than that their owners need the money. We are not near the third phase yet, and when we do approach it I will discuss the situation in great detail.

For the edification of readers, I am updating the broad Value-Line (unweighted) Industrial Average, and this is pictured along with the weighted Dow Industrial Average. The comparison here explains much about the current agony of the typical stockholder. According to Value-Line, Industrial stocks on average lost better than half of their value during the 1969-70 crash. But surprisingly, Value-Line shows that Industrials failed to regain even half of their 1969-70 losses during the 1971-73 recovery. Most recently, the Value-Line Industrials have given up more than half of their meager 1970-73 gains, and this broad Average is therefore within shooting distance of its 1970 bear market low.

In all, however, I would say that the broad market has shown no progress since the 1966 highs. And the reason is patently clear. For despite every kind of Government "hype" and manipulation, the force of the bear was exerting itself, holding back and checking the majority of stocks, while a selected few glamor stocks and Dow stocks served to perpetuate the illusion that all was well on Wall Street.

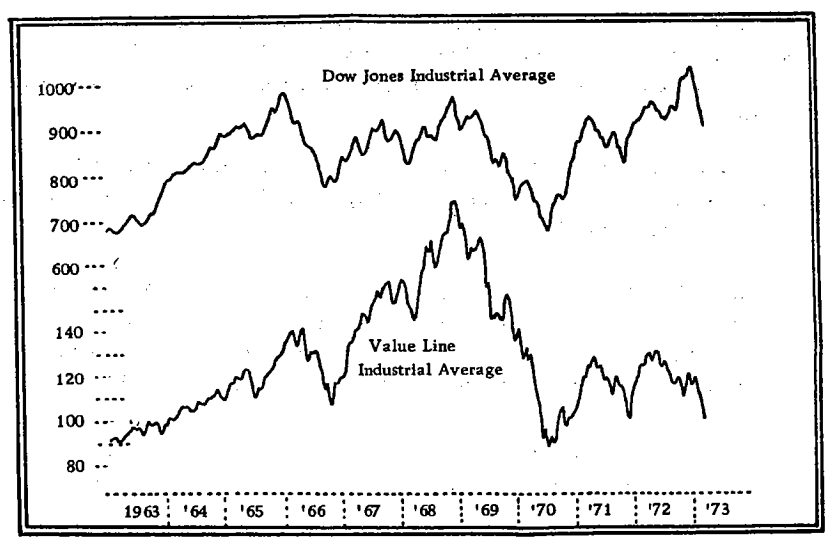
SHORT TERM: Turning to the current market and the page 1 chart of the Averages, we see that both Industrials and Transports have sunk (on their latest decline) to new 1973 lows. Nevertheless, as stated in Letter 557 (page 1) the critical point for the market, as far as Dow's Theory is concerned remains the 910.45 low of July 20, 1972. I am not going to go over the Dow Theory explanation regarding the importance of the 910.45 Industrial low (refer to Letter 557), but suffice it to say that any close below that figure on the part of Industrials will constitute a major bearish signal and would result in the complete destruction of the price structure of the market (as seen in the profile of the D-J Averages).

Note on the Dines point & figure chart that the Dow has bounced off the 910 area. Thus, the current rally (which began March 25) could be building a "right shoulder" for a giant "head-and-shoulders" top, as depicted on this chart. At any rate, it is possible that the downside action is exhausted for the time being and that further distribution will now occur as this rally progresses.

HIGH-LOWS: One of the most extraordinary records of the past three years is provided by the weekly tabulations of the new highs and lows. The page 4 chart shows the differentials in the weekly high-lows (weekly lows minus weekly highs, or the reverse if there were more lows than highs). These figures are plotted together with the weekly (Friday closings) for the Dow.

What we see here is a steady contraction of new highs over the past three years and a persistent expansion in new lows. So dramatic is this trend that we can actually run a trendline through the major descending peaks in new highs, the 534 new highs of January 22, 1971, the 295 new highs of March 3, 1972, and the 158 new highs of December 8, 1972. On the downside we have the minus 453 new lows of November 26, 1971, and the minus 943 new lows of March 26, 1973 (the last recorded only a week ago).

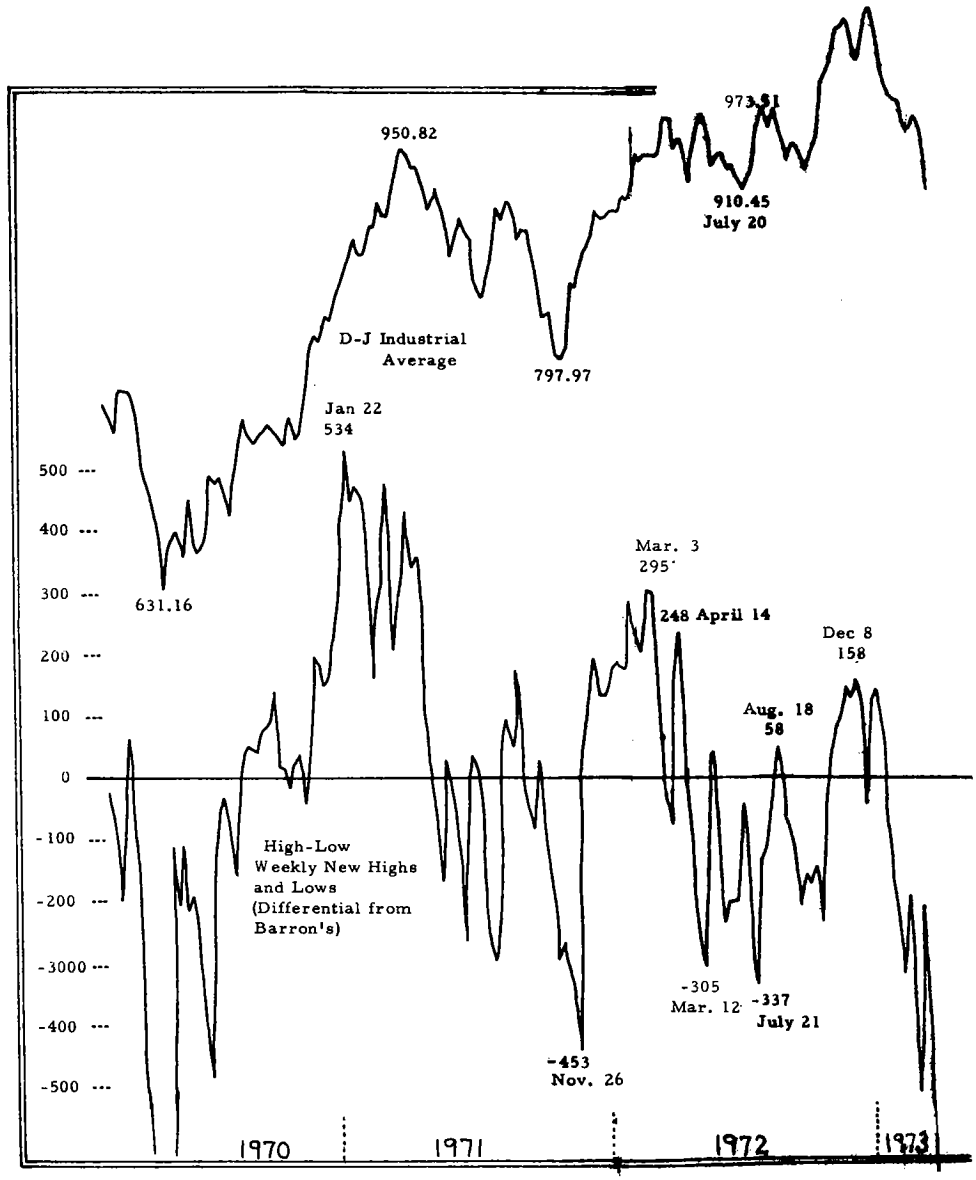
This study is really portraying the broad forces of buying power and selling pressure. For instance, during a major advance many stocks will "break



out" of their trading ranges and push to new highs for the year. If the advance is a strong one, an increasing number of stocks join the new high parade while the earlier new highs continue to make the list. Thus, the entire new high picture becomes one of ascending peaks on the chart. We can see this in the action (refer to chart) leading up to the January, 1970, peak.

Conversely, during broad weakness the same action occurs in reverse, with each new wave of weakness adding newcomers to the low list. Finally, as during the week of March 23, 1973, one-third of all the common stocks on the NYSE registered new lows and the selling pressure became widespread, obvious and very costly.

This chart is telling us that the market since early 1971 has been a fooler, it has been under liquidation, and it has decimated the average portfolio. The 1969-70 smash terminated with a minus 1314 on the weekly high-low index (week of May 29, 1970). That figure included roughly two-thirds of all NYSE stocks. I expect this bear market to surpass the 1970 low record of minus 1314 before the year is out. Admittedly, that will take some doing.



MARKET NOTES: Mutual fund redemptions and the resulting security sales are becoming a force to be reckoned with. In February funds sold $563 million in securities, highest amount in history. Over the last 14 months, funds liquidated securities on balance during 11 of the 14 months. The largest previous month's liquidation was the $425 million of February, 1972.

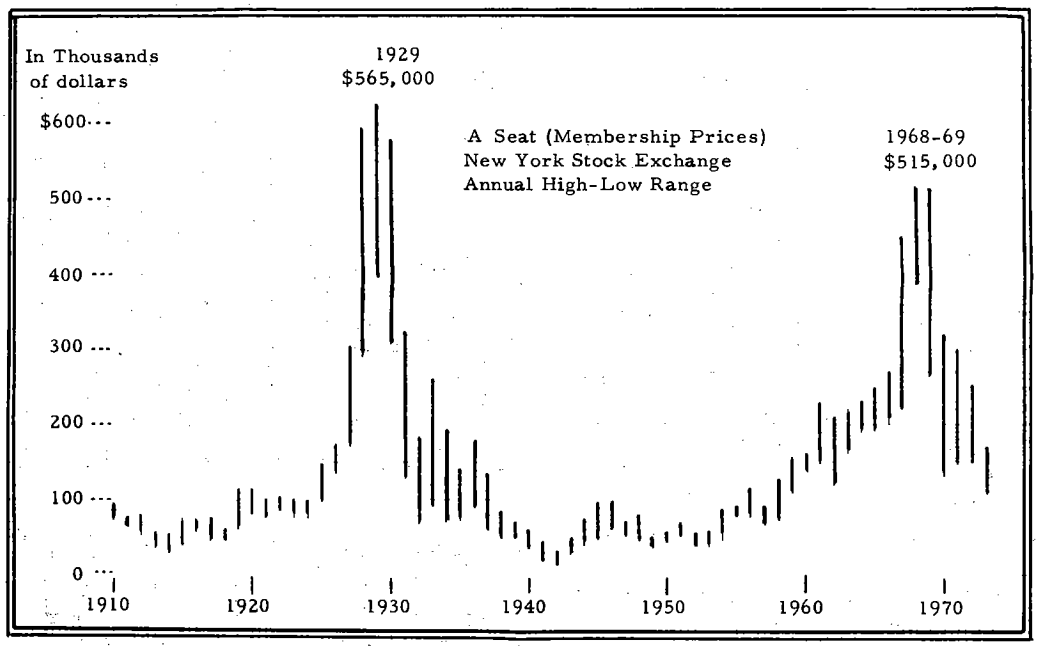
Bill Gordon writes me that the Dow short interest ratio is now .53, a new low position. But adjusting for the huge arbitrage short situation in Telephone brings the short ratio in the Dow down to .25! This is the lowest figure on record going back to 1931, and indicates far, far too much bullishness regarding the Dow stocks (in that the speculation for their decline is far too small).

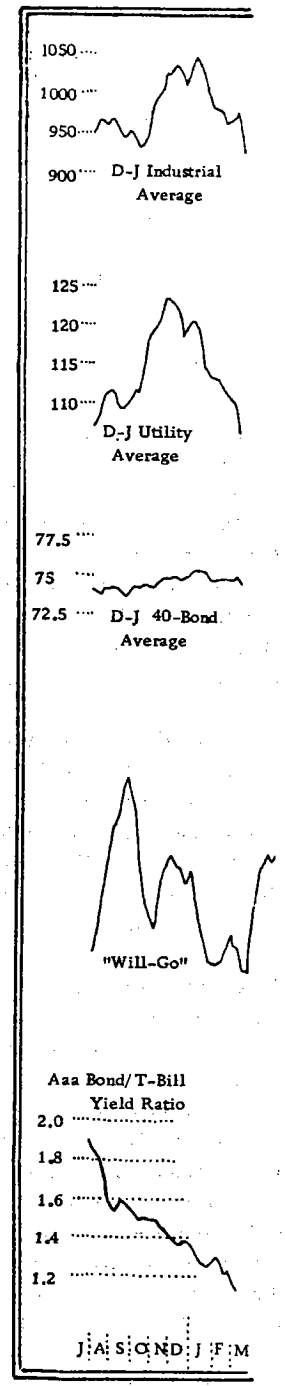
The number of stockholders and mutual funds holders dropped in 1972 for the first time since the records on these statistics began (since 1952). Figures showed a drop from 32.5 million holders at year-end 1971 to 31.7 million at year-end 1972. Just "a straw in the wind," but...

MONEY CHART: I am including the chart (page 5, on right) of the four indicators which I use to gauge the effects of money on the stock market. Veteran readers know my rule that whenever the D-J Utility and 40-Bond Averages go down in unison, it is a bearish omen for the market (a bearish money interest rate situation is almost always responsible for driving these two sensitive indices down). Last week, it should be noted, both Utilities and the D-J 40 touched new lows for the year.

"Will-Go" (see Letter 554) which points to forthcoming market directions, calls for a market rally to start around the first week in April, the rally to last for at least a month (remember, Will-Go deals with market direction, never extent).

Finally, the Aaa Bond/T-Bill yield ratio last week dropped to a very bearish 1.14, well below the all-out "sell signal" level of 1.20. So that's the picture on the four money indices. They did an excellent job in warning us of this market decline. Three of the four are still bearish with Will-Go pointing to a potential respite starting in early April.





COLD SEAT: I remember an old cartoon, I think it appeared in the New Yorker sometime during the 1940's, and it showed two stock brokers looking across Wall Street at a third broker who was out on the ledge of his building. Still looking at their friend on the ledge, the first broker turns to the second and comments wryly, "Do you think that Smedly knows something that we don't?"

I remembered this rather frightening cartoon after I drew the accompanying chart of the annual high-low range of seat prices on the NYSE. The chart shows the great rise from the 1914 low price of $34,000 to the 1929 peak of $565,000 for a membership seat. Then seat prices plunged to a final low of $17,000 in 1942, a year when volume was running around a million shares a day.

From the 1942 low, the price of a seat moved up to the $515,000 peaks of 1968 and 1969. In 1970 the price of a seat hit a low of $130,000. There was a slight rally in 1971 and 1972 as market volume flaired. But last week the price of a seat plunged to $95,000, lowest since 1958. Based on the 1,366 seats on the NYSE, the members have now suffered a combined loss of over half a billion dollars. Who says Wall Street itself doesn't lose during a bear market!

But it is the profile of the 1968-73 slide, as compared to the post-1929 slide that I find so ominous. All of which prompted me to recall the old cartoon and with it the nagging question, "Do those who buy and sell memberships on Wall Street know something that we don't know?"

PROGRESS REPORT: Since 1950 US percentage of world steel production has dropped from 47% to 19%. Since 1950 US exports as a percentage of world exports have dropped from 18% to 13%. Since 1951 US gold and reserves as a percentage of the world's reserves has dropped from 42% to 8%. Since 1960 US auto production as a percentage of world auto production has dropped from 46% to 30%. But in 1973 the US stands alone in one category: The US Government now spends $28 million each and every hour of the day.

Gold Fever Hits San Franciscans

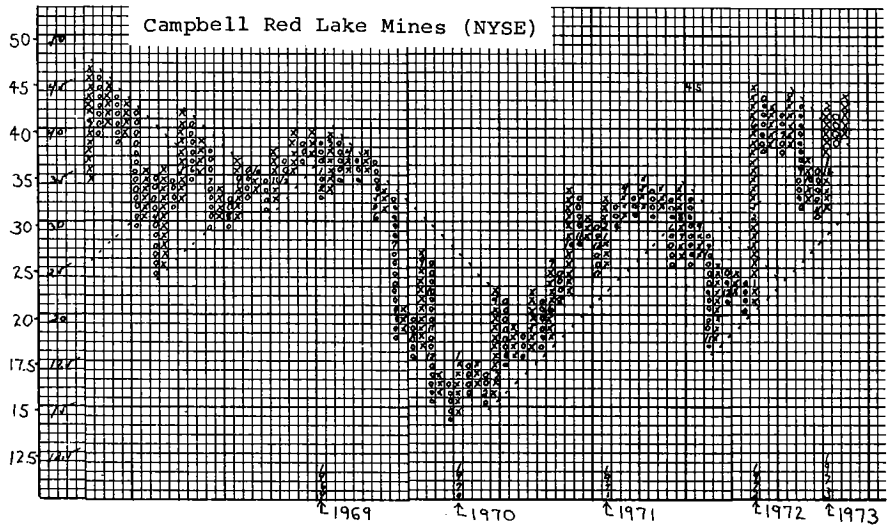
SAN FRANCISCO (AP) — Taking their cue from the prospectors of over a century ago, San Franciscans are again succumbing to gold fever and rushing to scoop up all the precious metal they can find.

"We've been swamped," said coin shop owner Steve Ahajanian in an interview. "Even the ordinary working stiff who never bothered with coins has gold fever. They've cleaned us out. They want to hold on to something solid.

"A $20 gold coin that I sold for $100 last December is now worth $165 — a 65 per cent jump in just three months."

Where will it all end? As it usually does — with a fall of the currency. I have written many times regarding the "fever" which I believe will hit the public when they realize that their dollars are moving closer and closer to "museum relic" status. In view of this, I thought the item from last week's Associated Press release was interesting (page 5, bottom).

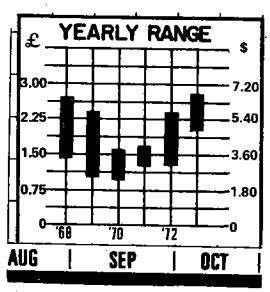
GOLD: On March 26 the London price of gold struck an official "second fixing price" of $90, an all-time high. This had the effect of booming many of the gold shares, particularly the S. African shares with Kloof, Vaal Reefs and President Steyn all going to record highs.



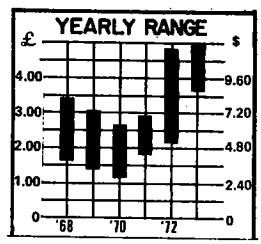
Interestingly, economist Pierre Rinfret, on March 22, announced that gold "could soon rise as high as $150 dollars an ounce." Since Rinfret has Mr. Nixon's ear, I was more than interested in this one. On March 27 my friend Elliot Janeway stated (at the meeting of the NY Society of Security Analysts) that "the price of gold should reach $125-130 by December." Rinfret and Janeway don't always agree, but when they do, wise men might pay heed to the subject agreed upon!

I am including a point & figure chart of Campbell Red Lake Mines (CRK), the chart courtesy of Chartcraft, Larchmont, NY 10538. To my mind, what this chart shows is the "biggest base pattern on the NYSE." This chart covers the action from 1969 to the present, with each box equalling one point in price. All rallies and declines of 3 points or more shown are depicted in this 1 point - 3 point reversal chart. The X's denote rallies, the O's indicate declines.

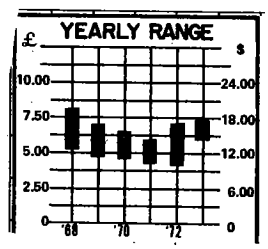
I see this entire formation as a massive "head-and-shoulders" bottom formation which is very near the breakout point. I would say that a price of 48 should send CRK on its way. I am not an all-out exponent of the "count" predictive properties of P & F charts, but I often take the P & F because it can prove so interesting. Chartcraft lists the upside count on CRK as 67. Using a vertical based on the major 1972 rise from 22 to 45, I get a peak possible count of 92. A horizontal count if one considers the entire formation pictured as a base, would give an upside "target" too high to be "reasonable." At any rate, I would guess that if CRK pushes up into the 48-49 area, thus breaking out of this huge base, this could constitute the signal for a major and exciting move in the gold shares. Intuitively, I view CRK as a bellwether gold stock at this time.



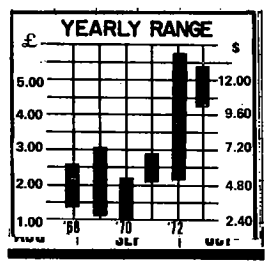
Blyvoors



Kloof

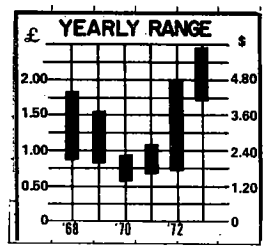


President Brand



President Steyn

I have included five little annual high-low charts depicting leading S. African gold mining equities, all available via ADR's. All have been recommended here repeatedly, and all are doing well. I thought these annual charts would provide an interesting perspective as to the action of some of the better Kaffirs at this time. All of these shares are currently selling at or near the peaks of their 1973 range, and all are recommended for purchase if you have not yet taken a position in gold shares (charts courtesy of Kaffir Chart Service, Palisades Park, NJ 07650).



Welkom

LATE NOTES: Amer. S. African hit an on-balance-volume high for the year on March 26, and this has bullish connotations. President Brand (see chart) hit a bid of 18 on March 27, highest in five years.

The Dow leaped 17 points on March 26, thus bouncing out of its "oversold" position. The action of the market from here on should prove fascinating, and breadth and volume could be the key as to whether a "right shoulder" is forming as per the page 3 chart.